

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. See 86 Ill. Adm. Code 130.220. (This is a GIL).

June 28, 2002

Dear Xxxxx:

This letter is in response to your letter dated April 6, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

AAA is requesting a written response regarding the proper procedure to follow when AAA (Lessor) leases commercial trucks to a company (Lessee) operating the vehicles in Interstate Commerce. Please identify any exemptions from sales, use, and motor vehicle excise tax when leasing commercial vehicles to common carriers. Also please indicate what documentation the Lessor must request from the Lessee in order to substantiate the tax exemption. If no exemptions exist in your state please indicate the proper tax treatment on these leases.

AAA is a STATE based leasing company which is registered to transact business and bill and collect sales/use tax in your state. We frequently purchase motor vehicles, trucks, tractors, trailers and semi-trailers to lease to our customers. The majority of our leases are considered to be long-term however we are also inquiring about the treatment on short-term leases as well.

Assuming AAA provides the vehicle vendor/dealer with our resale certificate, would the rental receipts from the true lease transaction be exempt from sales/use tax if the Lessee was an Interstate Commerce Carrier? If an exemption exists please indicate what documentation we need to obtain for our records from the Lessee. If our Lessee registers the vehicles under the International Registration Plan are any of the procedures different? In many cases the Lessee titles and registers its vehicles in one state and domiciles the vehicles in another. If the Lessee garages their vehicles in your state and registers the vehicles out of state does use tax apply? Would the policies and procedures change if AAA entered into a finance lease transaction rather than a true lease with the Lessee? A finance lease differs from a true lease in that Lessee has title and AAA has a security interest in the vehicles.

Please answer the above questions also assuming that the Lessee is not an Interstate Commerce Carrier. Since the lease would be taxable without an applicable exemption, would tax be due at the time of vehicle registration, or is it due on the monthly rentals of the lease? Is the tax imposed on the Lessor or on the Lessee? Please indicate any

differences in tax treatment if the lease was a true lease or a finance lease. Also, please address the scenario above regarding out of state registrations assuming the Lessee is not a common carrier. How does tax apply in that situation?

Please send your response to me at:

NAME/ADDRESS

DEPARTMENT'S RESPONSE:

LEASES

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. For items that are required to be titled and registered with an agency of this State's government, the entire amount of tax is due "up-front" before the item can be titled or registered.

Your letter seeks guidance regarding "finance lease transactions." You have described these transactions as differing from true leases in that the "lessee" has title and the "lessor" has a security interest in the vehicles. Generally, if the "lessor" is transferring title to the "lessee", the Department would not consider that transaction to qualify as a true lease. The "finance lease transactions" described in your letter would generally be treated as conditional sales for Illinois Retailers' Occupation Tax and Use Tax purposes. However, we cannot provide you with any specific ruling without examining a copy of the lease. We hope that the following general information that follows will be helpful.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of the enclosed copy of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of

the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

There are some limited exceptions to the general rule described in the preceding paragraph. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under leases of one year or longer. See the enclosed copy of 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See the enclosed copy of 86 Ill. Adm. Code 130.2011.

ROLLING STOCK EXEMPTION:

The Illinois Retailers' Occupation Tax and Use Tax do not apply to sales of tangible personal property to interstate carriers for hire for use as rolling stock moving in interstate commerce. The Department's rules governing the rolling stock exemption are found at 86 Ill. Adm. Code 130.340, copy enclosed.

The exemption applies to sales of tangible personal property to lessors under leases of one year or longer executed or in effect at the time of purchase with interstate carriers for hire for use as rolling stock moving in interstate commerce. A lessor will not incur Use Tax on the purchase of the vehicle that is leased to the interstate carrier for hire for use as rolling stock moving in interstate commerce under a lease term of one year or longer. See 35 ILCS 105/3-55(b) and 120/2-5(12). If a lessor leases a vehicle to an interstate carrier for hire under a lease term of less than one year, the rolling stock exemption is also available because the tax does not apply to the use by (or sale to) lessors, owners, or shippers of tangible personal property that is utilized by interstate carriers for hire for use as rolling stock moving in interstate commerce. See 35 ILCS 105/3-55(c) and 120/2-5(13).

Effective August 14, 1999, motor vehicles, trailers, and property attached to those motor vehicles and trailers must carry persons or property for hire in interstate commerce on 15 or more occasions within a 12-month period to qualify for the exemption. See 35 ILCS 120/2-51. For other types of property used in interstate commerce, the interstate carriers must be able to show, from their books and records, that the property has moved in interstate commerce for hire on a regular and frequent basis in order to qualify for the exemption.

Purchasers also must be recognized by the appropriate federal or state regulatory agency as interstate carriers for hire and have received a Certificate of Authority to engage in interstate commerce. Please note that it is not the type of item that determines whether or not it qualifies as rolling stock, but rather how a qualifying interstate carrier uses the item. In addition to receiving the proper Certificate of Authority, purchasers should be aware that only those items used specifically as rolling stock would qualify. See the enclosed copy of 86 Ill. Adm. Code 130.340.

When making a purchase of qualifying property, the purchasers must provide the sellers with a certification that they are interstate carriers for hire and that they are purchasing the property for use as rolling stock moving in interstate commerce. If the purchasers are lessors, the purchasers must

give the sellers a certification to that effect identifying the lessee interstate carriers for hire. Form RUT-7, Rolling Stock Affidavit, which is signed by the purchasers, is used to provide the required certification in order to execute the statutory exemption.

You have asked whether the registration by the lessees of the vehicles under "International Registration Plan" impact the taxability of the leases. We do not have sufficient information regarding that plan to determine what, if any, impact it would have on the taxation of the leases.

You have also asked if use tax applies when a lessee garages their vehicles in this State and registers the vehicles in another state. As noted above, lessors will incur an Illinois Use Tax liability on the vehicles that are used in this State (for lease or other types of use). Garaging the vehicles in this State will generally subject an owner/lessor to Illinois Use Tax liability on those vehicles regardless of where those vehicles are registered. The Use Tax liability is incurred because the term "garaging" a vehicle in this State is normally considered to mean that the vehicle is used (driven and parked etc.) in this State.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.